INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	3
Argument	5
Conclusion	11

CITATIONS

Cases:

Blair v. *Byers*, 35 F. (2d) 326	7
Canavan v. *City of Mechanicville*, 229 N. Y. 473	10
Columbus v. *Mercantile Trust Co.*, 218 U. S. 645	9
Denman v. *Commissioner*, 73 F. (2d) 193	6, 7
Flint v. *Stone Tracy Co.*, 220 U. S. 107	6, 11
Halsey v. *Helvering*, 75 F. (2d) 234	7
Helvering v. *Powers*, 293 U. S. 214	5, 11
Hoskins v. *Commissioner*, 84 F. (2d) 627	
Jamestown & Newport Ferry Co., v. *Commissioner*, 41 F. (2d) 920	8
Matter of Water Comrs. of White Plains, 176 N. Y. 239	10
Oakes Mfg. Co. v. *City of New York*, 206 N. Y. 221	10
South Carolina v. *United States*, 199 U. S. 437	11
United States v. *California*, 297 U. S. 175	5

Statute:

Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 22	2

Miscellaneous:

Treasury Regulations No. 74:	
Art. 643	2

103574—36

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 451

WILLIAM WHITLOCK BRUSH, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 14–17) is not reported. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 43–49) is reported in 85 F. (2d) 32.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 20, 1936 (R. 50). The petition

for a writ of certiorari was filed October 9, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the salary received by the petitioner as chief engineer of the Bureau of Water Supply of the City of New York constitutes income taxable by the United States Government.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, * * *.

Treasury Regulations No. 74:

> ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (*a*) the person receives such compensation as an officer or employee of a State or political subdivision, and (*b*) the

services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are subject to tax for 1928 and subsequent taxable years.

STATEMENT

The material facts, as found by the Board of Tax Appeals (R. 14–17), are set forth below:

The petitioner during the calendar year 1931 was employed as chief engineer of the Bureau of Water Supply of the City of New York. He has been so employed for thirty-six years. This is a statutory office. His duties as chief engineer included the protection of the water supply of New York City from pollution, the determination of the amount of water to be withdrawn from various sources, the operation of the municipal water system, supervision of personnel, all matters connected with the expenditure of moneys allocated for water supply purposes, and the preparation of plans, surveys, and reports on improvements and installations of the water supply system. (R. 14–15.)

In the early days of New York City, water was furnished its citizens by private companies. In certain areas, water is furnished and sold by private companies at the present time. The present water-supply system of New York has been built up through the years by the construction of facilities by the city and the acquisition from time to time of private companies supplying certain areas (R. 15).

Water furnished by the city for business use is metered and the amount used is charged at a fixed rate. Water for private use is furnished on a flat annual sum basis, which is determined in accordance with the conditions that exist with respect to the particular residence served. Approximately 75% of the cost of maintaining and operating the water system of New York City is attributable to the furnishing of water for business and private use; approximately 25% is attributable to fire protection, street sprinkling and flushing, sewer flushing, supervision of private companies, and the supplying of water to communities outside of New York City (R. 15).

The municipal water system of New York City has entailed an enormous expense. The cost of the facilities for bringing water from the Catskills involved an expenditure of more than two hundred million dollars. A plan for additional water supply now under consideration contemplates an expenditure of two hundred and twenty-five million dollars. The sources of water supply of the several private companies now serving some of the outlying sections of the city are nearing a condition of exhaustion (R. 15–16).

The Board of Tax Appeals concluded (R. 17) that the salary received by the petitioner as chief engineer of the Bureau of Water Supply of the City of New York was taxable income, and the court below affirmed the decision (R. 50).

ARGUMENT

The petitioner seeks exemption from Federal income tax of his salary as chief engineer of the Bureau of Water Supply off the City of New York. The court below held (R. 49) that the task of supplying water did not come within the "usual governmental powers" contemplated by this Court in *Helvering* v. *Powers,* 293 U. S. 214, nor did it meet the "traditional" test referred to in *United States* v. *California,* 297 U. S. 175, 184. It concluded that (R. 47) the case "falls within the realm of necessary accommodation" so essential under our dual system of government, and that the petitioner's salary was not immune from taxation. We submit that the decision below is clearly correct.

The ultimate inquiry in every case of this type is whether the particular activity undertaken by the State or its political subdivision is in the exercise of its strictly and essentially governmental powers or functions. That question requires consideration not only of the nature of the activity, but also of the fundamental reason underlying the adoption of immunity. *Helvering* v. *Powers, supra,* pp. 224-225. The activity may be for a worthy public purpose or for the convenience and welfare of the people, but it is not for that reason governmental. *Helvering* v. *Powers, supra,* p. 225.

The court below, after a full consideration of petitioner's contentions, reached the conclusion that the city of New York was engaged in a business activity in the operation of its water system.

The decision below is in full accord with *Denman* v. *Commissioner,* 73 F. (2d) 193 (C. C. A. 8th), and with the principles enunciated by this Court in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, to the effect that (p. 172):

> It is no part of the essential governmental functions of a State to provide means of transportation, supply artificial light, water, and the like. These objects are often accomplished through the medium of private corporations, and, though the public may derive a benefit from such operations, the companies carrying on such enterprises are, nevertheless, private companies, whose business is prosecuted for private emolument and advantage. For the purpose of taxation they stand upon the same footing as other private corporations upon which special franchises have been conferred.
>
> The true distinction is between the attempted taxation of those operations of the States essential to the execution of its governmental functions, and which the State can only do itself, and those activities which are of a private character. The former, the United States may not interfere with by taxing the agencies of the State in carrying out its purposes; the latter, although regulated by the State, and exercising delegated authority, such as the right of eminent domain, are not removed from the field of legitimate Federal taxation.

In *Denman* v. *Commissioner, supra,* the court held that the salary of the manager of the waterworks system owned and operated by the City of Des Moines, Iowa, was not exempt from Federal income tax, since the operation of the waterworks was not the exercise of a governmental function, though about 40% of the water was used by the city. See also, to the same effect, *Blair* v. *Byers,* 35 F. (2d) 326 (C. C. A. 8th).

There is no authority to the contrary. The cases cited by the petitioner, discussed below, deal with different types of governmental functions and furnish the petitioner no support.

Halsey v. *Helvering,* 75 F. (2d) 234 (App. D. C.), is not, as the petitioner asserts (Pet. 7, 14), in conflict with *Denman* v. *Commissioner, supra,* and is not opposed to our contention. There, the taxpayer was the city engineer of two New Jersey municipalities, and his duties consisted of advising the municipalities on all engineering matters, which included specifically construction, maintenance, and alteration of streets and ways, sewers, waterworks, and lighting systems; the preparation of plans and specifications and maintaining custody of the same. While advice and preparation of plans in connection with waterworks were among his duties, the taxpayer's employment was in connection with all engineering matters of the towns and his services were rendered only in furnishing the town authorities with information

upon which they could act. His services were not rendered solely in operating or carrying on a private business venture, the waterworks system. In the instant case, the petitioner was employed solely in the operation of the waterworks system, which, we submit, is an enterprise or business private in character.

Nor does the case of *Hoskins* v. *Commissioner,* 84 F. (2d) 627 (C. C. A. 5th), relied upon by the petitioner (Pet. 10, 14) furnish any support. We submit that the Circuit Court of Appeals in deciding that case had no intention of laying down a new test for granting the immunity. The gist of that decision is the conclusion that the cafeteria under consideration was so interlinked with the administration of the public school system, which is a generally recognized governmental function, that the immunity should be granted to it as an integral part of that governmental function.

Jamestown & Newport Ferry Co. v. *Commissioner,* 41 F. (2d) 920 (C. C. A. 1st), relied upon by the petitioner (Pet. 14) did not involve the present issue of the taxability of the income of an employee of the instrumentality, but dealt solely with the taxability of the income of the instrumentality itself. The special statutory exemption from tax of income from public utilities operated by municipalities, which is not here involved, was there controlling. Though it was pointed out (p. 923) that the particular ferry was "essential to the normal life of this community", there was no intent in that

case to lay down a new test for tax exemption. Items such as food and fuel are likewise essential to the normal life of a community, and yet the furnishing of these items is clearly outside the scope of the contemplated immunity. In using the phraseology above quoted, the court was merely buttressing its conclusion that the ferry was in effect a public utility operated by the municipality within the meaning of the pertinent statute.

The language quoted by the petitioner (Pet. 11) from *Columbus* v. *Merchantile Trust Co.*, 218 U. S. 645, 658, considered in the light of the question there involved, can not, we submit, be construed as denying the principle established in the cases relied upon by the court below. That case involved merely the right of the city to construct and operate a waterworks system, when the private corporation to which it had granted a franchise to supply water failed to perform according to the contract, without being required to purchase the company's plant. It was in that connection that the quoted language was used. It can not, we submit, be interpreted to mean that where a city operates its own waterworks system it does so by virtue of its police or governmental power. It may well be within the police duties of the city to regulate and supervise the supply of water, but it certainly is no part of its duty as a sovereign governing its people to, itself, undertake the business of supplying water to the people. We do not here question the right of a municipality to furnish

water to its citizens, but it does not follow that, because a specified task falls within the authorized scope of municipal activities, such a task is to be regarded as such an essential governmental function as to entitle the employees engaged thereon to immunity from Federal income taxation.

While not controlling for Federal tax purposes, decisions of the New York courts dealing with liability of municipalities of that State engaged in operating waterworks provide us with a persuasive analogy, to the effect that the city is here acting in a proprietary rather than in a governmental capacity. These cases hold that while the business of maintaining a municipal water system and supplying water to private consumers at fixed compensation is public in its nature and impressed with a public interest, it is not an exercise of governmental or police power, and that a municipality so engaged acts in a private or proprietary capacity, in which it is governed by the same rules that apply to a private corporation so acting. *Matter of Water Comrs. of White Plains,* 176 N. Y. 239, 250–251; *Oakes Mfg. Co.* v. *City of New York,* 206 N. Y. 221, 228; *Canavan* v. *City of Mechanicville,* 229 N. Y. 473, 476. In view of these local decisions, the petitioner's reference (Pet. 13) to the local legislative determination that the "act can only be done by the State" would seem to be of no avail.

The petitioner (Pet. 9) erroneously assumes that this Court by employing the word "usual" rather than the word "essential" in the *Powers* case,

supra (p. 227), to describe the governmental functions which alone are immune from Federal taxation has in some way rejected the strictly narrow application of the doctrine established in prior decisions and has recognized the applicability of the rule of immunity in a broader field of state activities. Such an assumption is, we submit, without merit. We think that there was no intent to employ the word "usual" in the *Powers* case in any sense different from the word "essential" used in the *Stone Tracy Co.* case, *supra* (p. 172), or the words "ordinary" and "strictly" used in *South Carolina* v. *United States,* 199 U. S. 437, 451, 461. This seems evident from the citation and approval of the *Stone Tracy Co.* and *South Carolina* cases in this connection in the *Powers* case (p. 225).

CONCLUSION

The decision of the court below is correct. There is no conflict of decisions among the Circuit Courts of Appeals. The petition should be denied.

Respectfully submitted.

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